United States Senate
Republican Policy Committee
Jon Kyl, Chairman
347 Russell Senate Office Building
Washington, DC 20510
202-224-2946
http://rpc.senate.gov

Updated January 20, 2004
First Issued on November 22, 2003

Spending the Unemployment Trust Fund Dry:
Economic Recovery Threatened by Extension of Temporary Unemployment Compensation

Executive Summary

- Eligibility for the Temporary Extended Unemployment Compensation (TEUC) programs (enacted in 2002) closed at the end of December. Under the law's phase-out provisions, those eligible who filed claims before the end of December will still receive full benefits for up to 13 weeks in 2004.

- Some Senators have expressed support for continuing the temporary unemployment programs, even though the reason for their existence – a struggling economy – has largely abated. Unemployment dropped to 5.7 percent in December, the lowest rate on record in 2003 and the fourth straight month of decline. Gross Domestic Product grew by 7.2 percent in the third quarter of 2003 – and is expected to keep growing.

- An extension of the temporary programs is likely to impair the current economic recovery. Economists have found that increasing the duration of available benefits encourages people to remain unemployed.

- Due to the generosity of these additional benefits provided during the past 18 months, the Unemployment Compensation Trust Fund has been depleted by 50 percent. The irony – and the danger – of this scenario is that payroll taxes are what make up this trust fund; if it nears depletion, Congress and the states may need to increase payroll taxes – acts that *will discourage employment*.

- As the TEUC program phases out, $1.2 billion will be disbursed to unemployed workers between this month and March 2004. Additionally, workers who become unemployed today remain eligible for up to 26 weeks of state benefits – and if they reside in a state experiencing high unemployment, they are eligible for 39 to 46 weeks of benefits.

Introduction

In 2002, Congress passed the Temporary Extended Unemployment Compensation programs (known as TEUC and TEUC-X), providing temporary additional federal benefits to the unemployed. Congress extended the benefits in January 2003 and again in May. Now, some in Congress seek to extend the temporary programs again. As their names promise, the programs were designed to be temporary. They should be allowed to phase out, as provided under the law. The justification for these temporary programs, mainly a struggling economy, no longer exists. A continuation of the temporary programs would endanger the economic progress made in recent months by increasing the length of time recipients remain unemployed and threatening to bankrupt the Unemployment Compensation Trust Fund.

Unprecedented Generosity, Even While Unemployment is Not High

Permanent Program Benefits

The Federal and State Unemployment Compensation System consists of a number of compensation programs designed to provide weekly payments to recently unemployed individuals for a limited amount of time while they search for a new job.

The payments come from the Unemployment Compensation Trust Fund, which is composed of both taxes collected through the Federal Unemployment Tax Act (a 0.8-percent tax on the first $7,000 of private employees' wages, which is collected by the employer) and a state tax on at least the first $7,000 of private employees' wages. These taxes are deposited in the U.S. Treasury and disbursed by the federal government. Within the Trust Fund are separate state accounts.

The amount of compensation an unemployed worker receives on a weekly basis is determined by each state. Typically, an unemployment compensation check is at least half of the worker's previous salary, and each state has a cap on the maximum weekly benefit. The average weekly benefit in 2002 was $244 a week, with Massachusetts offering the highest possible weekly benefit at $768.[1]

There are three levels of benefits in the permanent Unemployment Compensation system. First, all states pay unemployed workers up to 26 weeks of benefits from state accounts in the Trust Fund. (Some states pay for up to 30 weeks.) A second level of benefits, "Extended Benefits" (EB) are available for workers who have exhausted the first level and reside in states with "high unemployment." The EB program provides an additional 13 to 20 weeks of unemployment benefits to recipients. States have two options for defining what will constitute "high unemployment" in their state, but it is generally a high insured unemployment rate plus an increase in that rate of 10 percent or 20 percent over the previous two years. EB benefits are funded jointly by the federal and state Trust Fund accounts.

[1] CRS, *Unemployment Compensation: A Fact Sheet*, September 5, 2002, 94-417.

Thus, under the permanent state and federal unemployment systems, all unemployed workers are eligible for benefits for up to 26 weeks – and if they reside in a state experiencing high unemployment, they are eligible for 39 to 46 weeks.

In addition, Congress in March of 2002 transferred $8 billion in Trust Fund money to all states to augment their unemployment compensation systems.[2] The states have yet to spend more than $5 billion of these funds. Of the 16 states and territories that have spent none of their additional funding, four have higher unemployment than the national average.[3] Meanwhile, the Trust Fund's balance has been reduced by 50 percent over the past 18 months, from $39 billion to $19.7 billion.

Some argue that the requirements for a state to qualify for EB are too restrictive. During challenging economic periods when unemployment is higher, temporary programs have sometimes been enacted to provide additional benefits to workers who live in states that do not meet the "high unemployment" standard to qualify for EB. In the past, temporary programs have sometimes superseded EB benefits (i.e., states either get one or the other). In contrast, the current temporary program enacted in 2002 provides additional benefits.

Recent Temporary Extended-Benefit Programs

Since the EB program was created in 1970, Congress has passed five temporary, federally-funded, extended-benefit programs to supplement EB.[4] Unemployment rates during these programs were, on average, much higher than what was experienced during this most recent downturn: since passage of TEUC, unemployment rates have averaged 5.9 percent. In comparison, during the periods in which the last three temporary programs were in effect, the unemployment rate averaged 7.1 percent (1991-1994), 8.6 percent (1982-1985) and 7.8 percent (1975-1977). Congress has also spent more Trust Fund dollars on the TEUC program than on any previous temporary program. This current program is projected to cost at least $30.8 billion – assuming it will phase out as scheduled.

Temporary Extended Unemployment Compensation (TEUC) Benefit Levels

The current temporary programs have been extended twice and, although they began to phase out at the end of December, will continue to provide $1.2 billion in benefits into March. The current programs are so generous that they could allow certain unemployed workers (see below) to receive

[2]The Reed Act, passed as part of the Employment Security Financing Act of 1954, authorizes the automatic transfer of funds from federal to state accounts in the Unemployment Trust Fund when federal funds exceed specified levels. States may use these funds for enhanced benefits, increasing eligible workers, employment services, or administration. In 2002, Congress mandated the first transfer under the Reed Act since 1958.

[3]Department of Labor and House Ways and Means Committee; see also, GAO, *Unemployment Insurance: States' Use of 2002 Reed Act Distribution,* March 2003, GAO-03-496. The four are: Alaska, Oregon, Puerto Rico and Washington.

[4]2002-2003, 1991-1994, 1982-1985, 1975-1977 and 1972-1973.

benefits of up to *102 weeks* (26-30 weeks of regular benefits +13 weeks of TEUC + 13 weeks TEUC-X + 13-20 weeks of EB; for aviation workers, 26-30 weeks of regular benefits + 39 weeks of TEUC-A + 13 weeks of TEUC-AX + 13-20 weeks of EB):

> ***TEUC*** **–** The TEUC program provides additional federally funded benefits of 13 weeks for unemployed workers – payable once the benefits available under the permanent state Unemployment Compensation program (i.e., 26-30 weeks) have been exhausted.
>
> ***TEUC-X*** – An additional 13 weeks of federally funded benefits are available for residents in states with high unemployment after exhausting TEUC. Fourteen states have qualified over the course of the program. (Note, this program uses a different formula than the EB programs, and so states are more likely to qualify for TEUC-X than for the EB program.)
>
> ***TEUC-A*** **–** TEUC-A applies to the aviation industry. Aviation workers are eligible for an additional 39 weeks of benefits under the TEUC-A program, and those in high- unemployment states are eligible for another 13 weeks of benefits under the TEUC-AX program. These benefits are available to some 67,000 airline and downstream industry workers that separated from employment due to terrorist actions, security measures, or the war in Iraq – at a cost to the federal Trust Fund of $300 million.[5] These benefits will be available through December of 2004.

As Temporary Programs Phase Out, Several Options Available

As these temporary programs phase out early this year, the Senate faces several options. Some Democrat Senators prefer legislation that would both extend the current program and expand its benefits to more people (S. 1708); other options include a straight extension of the current temporary program; a "wind-down" program that would extend benefits but with shorter durations, or a phase-out of the temporary program, as provided by current law.

Senator Kennedy is the lead sponsor of the proposal to extend the current program for six months and expand it to include part-time workers, low-wage workers, and enhanced benefits for railroad workers – at an additional cost of $17.5 billion, according to the Congressional Budget Office (CBO). The cost estimate produced by the CBO also assumed that increasing the benefit level would "result in individuals collecting regular unemployment benefits for a slightly longer period of time than if the additional benefits were not available," and attributed $1.5 billion of the cost of the bill to this pattern of behavior.

Senator Smith has proposed a straight, six-month extension of the existing temporary program (S. 1839) – at a cost of $5.6 billion. An alternative extension, a wind-down, previously was implemented. When the 1990s program was terminated by a Democrat-controlled Congress, the

[5] Department of Labor; provision enacted in the 2004 Emergency Wartime Supplemental Appropriations bill [P.L. 108-11].

benefit period was extended, but shortened. For example, Congress could extend the temporary programs for four months, but reduce the duration of benefits from 13 to 7 weeks for TEUC and to 6 weeks for TEUC-X. This example would cost $1.9 billion, according to preliminary CBO estimates.

Finally, the Senate may opt to allow the programs to phase out as provided under current law. This phase-out did not suddenly end benefits to the nation's unemployed just as the Christmas spending bills came in. Rather, workers who had not yet exhausted their 26 (or more) weeks of traditional benefits by the end of December 2003, are continuing to receive them until they are exhausted – and then they are eligible for the Extended Benefits program if they reside in a qualifying state. And every unemployed worker who exhausted the permanent benefits prior to the end of December 2003, and thus became eligible for the TEUC benefits, will receive the full amount of these benefits until exhausted. Only the door to new eligibilities – under the TEUC programs – has closed.

Congress's Actions Could Impair the Economic Recovery

As the Senate reviews its choices, it should remember three things:

- First, the economy is recovering – eliminating the justification for another extension;
- Second, a continuation of the temporary extended-benefit programs could endanger the economic recovery; and,
- Third, Congress has spent more on extended benefits for this period of higher-than-normal unemployment than for any other high-unemployment period – despite the fact that the average unemployment rate during this downturn has been lower. This may set a costly precedent for future economic downturns.

The Economy is Recovering

Numerous economic indicators show that the economy is well on the road to recovery. Gross Domestic Product grew by 7.2 percent in the third quarter of 2003 – the fastest growth in nearly 20 years. Consensus economic forecasts suggest that it will grow by at least 4 percent in the fourth quarter of this year and the first quarter of next year. And, jobs are being created again. Payroll employment has seen significant increases. Though last month's increase of 1,000 new jobs was less than expected, it followed on a five-month upward trend, including 126,000 new jobs in October and 125,000 new jobs in September.[6] The unemployment level is down to 5.7 percent, from 5.9 percent last month. And

[6] Department of Labor, Unemployment Situation data.

the number of people who have reported being employed has increased by 1.8 million since the end of the recession.[7]

<u>Continuing Temporary Extended Benefits Will Endanger This Economic Recovery</u>

If the temporary program of extended benefits is continued, it could actually stall the economic recovery because it will delay workers' re-entrance in the workforce and could discourage some employers from expanding their workforce if they cannot find workers with the level of qualifications they demand.

Although a good economy requires willing workers, unemployment compensation provides a disincentive to work.[8] There is a connection between increased benefits and longer periods of unemployment. For example, a study of the temporary program enacted in the early 1990s showed that half of the recipients who became re-employed found jobs within three months of exhausting their benefits.[9] The trend is evident on a larger scale as well. When the 1990s temporary program was allowed to expire in February of 1994 (there was a phase-out that lasted until April), the unemployment rate was 6.6 percent. By the end of the year, it had declined to 5.5 percent – a full percentage-point drop. The current temporary program offers another stark example of the connection between increased benefits and higher utilization: one week after the TEUC program was enacted in March 16, 2002, initial unemployment claims increased by 120,000 claims from 376,000 to 493,000.

Economists have determined that the work disincentives of providing more generous unemployment benefits, whether by increasing the weekly amount of the unemployment benefit or extending the duration of benefit eligibility, would be dramatic. Economists who have researched the question confirmed that an increase in potential benefits duration increases the average duration of unemployment spells.[10] American Enterprise Institute economists have calculated that a 50-percent increase in the amount of unemployment compensation benefits creates a 50-percent increase in unemployment for those eligible for the benefit.[11] Applying that calculation to unemployment rates, they found that such an extension of benefits would raise national unemployment rates by nine-tenths of a

---

[7]BLS also employs the *household survey* that measures the number of individuals who report being employed. This measure indicates that the number of people employed has increased by 1.8 million.

[8]CRS, *Unemployment Compensation (UC)/Unemployment Insurance (UI): Trends and Contribution Factors in UC Benefit Exhaustion*, October 10, 2003, RL32111.

[9]Walter Corson, Karen Needels, and Walter Nicholson, *Emergency Unemployment Compensation: The 1990s Experience*, Mathmatica, January 1999.

[10]L.F. Katz and B.D. Meyer, *The Impact of the Potential Duration of Unemployment Benefits on the Duration of Unemployment*, Journal of Public Economics,(1990).

[11]Kevin A. Hassett and John R. Lott, Jr., *Unemployment Lines, Lies and Statistics*, New York Post, April 12, 2002.

percentage point – thus, that would raise the unemployment rate from the current level of 5.7 percent to 6.6 percent.

Another extension also endangers the economic recovery by ensuring higher deficits and payroll taxes. The legislation introduced by Senator Kennedy would nearly deplete the Trust Fund by spending $17.5 billion of the $19.7 billion that remains. If the Trust Fund goes into deficit, it automatically draws on the U.S. Treasury, thereby increasing the current budget deficit. The Trust Fund is financed through federal and state payroll taxes. If the Trust Fund is not drawing enough revenue, these taxes may have to be increased – making it more expensive for employers to maintain or increase their current payroll.

Historically High Benefit Level Sets Poor Precedent for Future Downturns

In future periods of downturn, Congress again will look to past programs to determine when to enact a temporary, supplemental benefit, how long to maintain it, and how generous benefits should be. With these current temporary programs, Congress has set a dangerous precedent. As cited earlier, Congress has spent more on these temporary programs than any other temporary unemployment program in history, and has done so in a shorter period of time and during a period of lower unemployment than ever before in U.S. history. And for the first time, Congress has enacted a targeted benefit, TEUC-A, for a particular group of workers. If future Congresses feel obliged to match or exceed the generosity of this program during bad economic periods, they may very well spend themselves into a permanent downturn.

Conclusion

These temporary unemployment compensation programs have served their purpose and should not be extended. They were created by Congress in 2002 and, since extended, are the most expensive temporary unemployment compensation programs in history. They are depleting the Trust Fund and have set a new and dangerous precedent in their costs and in their targeting of specific groups of workers.

Congress's action this year will serve as a precedent – good or bad – to future Congresses in times of economic downturn. If Congress expands or extends the program during this period of economic recovery, that action will reduce the Trust Fund to a point at which employers and employees may be forced to pay higher taxes to keep it afloat, thereby hampering the current economic recovery.